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Supreme Court of the United States

OCTOBER TERM 1941

No. 752

GIRARD INVESTMENT COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Supreme Court of the United States,

October Term 1941

Docket No. .....

GIRARD INVESTMENT COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MAY IT PLEASE THE COURT:

The petitioner, Girard Investment Company, by its attorney, Jackson R. Collins, respectfully shows to this Honorable Court:

A.

Summary Statement of the Matter Involved

The case involves tax liability *eo nomine* a surtax over and above all ordinary corporate income taxes under Section 351 of the Revenue Act of 1934 and corresponding

sections applicable in subsequent years. The amounts involved are: (R. 4)

Year	*Personal Holding Company Surtax*	*Penalty*
1934	$22,177.76	$5,544.44
1935	23,990.14	5,997.54
1936	9,892.24	2,473.06

The Commissioner of Internal Revenue determined deficiencies of personal holding company surtaxes and penalties for failure to file personal holding company returns on Form 1120-H. (R. 4) The United States Board of Tax Appeals affirmed the assessment and held the taxpayer liable. (R. 25) The United States Circuit Court of Appeals for the Third Circuit by Judge William L. Clark held the taxpayer liable for the personal holding company surtax, but remanded the case to the Board for further proof with respect to the imposition of the penalties. (R. 39)

The questions involved are as follows:

1. Is a second penalty tax, which is imposed to eliminate tax avoidance or evasion, a violation of the Fifth Amendment when it is grounded upon an arbitrary status contrary to fact and when there is a subsequent finding by Congress itself that there was no avoidance and no economic equivalence?

2. Is a form prescribed by the Commissioner of Internal Revenue a tax return when the information requested thereon is insufficient to determine tax liability? Is Form 1120-H for 1935 a mere computing, supplemental sheet and not a return?

The material facts are as follows:

1. Section 351 of the Revenue Act of 1934 imposes an income surtax over and above the ordinary income tax

levied upon corporations. Under this section there is imposed upon a taxpayer an additional surtax which is designed to be a penalty, to prevent or to eliminate the use of the corporate structure as a means to minimize individual tax liability through a personal holding company. Such a company is called an "incorporated pocketbook" in the Congressional Committee Reports; *H. Rept. 704, Ways and Means, 73rd Congress 2d Session, p. 11.*

2. Section 351 defines the elements of a personal holding company. A summary description of such a corporation is where more than 50 per cent of the outstanding stock is owned by five "persons" or less and where more than 80 per cent of its gross income is received from interest, dividends, capital gains and similar items. (R. 30) Much more than 50 per cent of the capital stock of the Girard Investment Company was owned by one individual, which fact was shown on Form 1120 for the year 1935 in Schedule C. (R. 21)

3. This taxpayer, the Girard Investment Company, is a corporation organized and existing under the laws of the State of Delaware. The taxpayer is duly qualified to do business in the State of Pennsylvania, and is licensed for each year by the Secretary of Banking under the Small Loan Statutes of Pennsylvania (Pennsylvania Small Loan Act of June 17, 1915, Chapter 432, Pamphlet Laws 1012, for 1915, as amended and codified in Purdon's *Pennsylvania Statutes* 1936, Title 7, Chapter 27, Sections 751-760, page 87), as a small loan company. (R. 5) The Girard Investment Company is one of the oldest of such companies in Pennsylvania and has about fifty (50) employees and fourteen (14) offices. (R. 6)

4. During the calendar years 1934, 1935, and 1936, which are the taxable years herein involved, the taxpayer expanded its business. It received more than 7,000 applications for

small loans in 1934, and 11,000 in 1936. (R. 6) It received 63,598 instalment loan payments in 1934 and 94,318 in 1936. (R. 6) These simple illustrative facts disclosed that the company was very active and directly engaged in the business of lending small sums of money. It was an active operating company and not a holding company and certainly not a personal holding company.

5. The taxpayer filed complete ordinary income tax returns on Form 1120 for each of the calendar years, 1934, 1935, and 1936. (R. 7) For the year 1935 the taxpayer gave in its return on Form 1120 more information than was required by the designated Form 1120-H called a "personal holding company return" under Section 351. This information better enabled computation and determination of liability for the personal holding company surtax now alleged to be due than that required on Form 1120-H. (R. 16, 22) No more information was requested by the Commissioner of Internal Revenue upon his printed Form 1120-H than was required on Form 1120 and supporting schedules which were duly filed under oath and in due form for the years 1934 and 1935 on or before the date required by statute for the filing of returns.

6. Form 1120-H for 1935 required no information on stock ownership. Therefore the form was inadequate to determine tax liability, if any, under section 351 of the Revenue Act of 1934.

7. The United States Circuit Court of Appeals for the Third Circuit upheld the decision of the United States Board of Tax Appeals insofar as the petitioner was held liable for the personal holding company surtax. The case was remanded for further proceedings on the question of whether there was reasonable cause for failure to file Form 1120-H in regard to the imposition of the penalty. The United States Circuit Court of Appeals for the Third Circuit found

that more than 80 per cent of the income of the taxpayer came from interest. (R. 30) It did not discuss the constitutionality of the statute involved which declared an active operating company to be a personal holding company, nor did it consider whether the creation of such status contrary to fact was justified as a necessary means to prevent tax evasion though much time and effort was used in presenting it to the court.

B.

Reasons Relied on for the Issuance of the Writ

I.

The facts clearly show that the taxpayer is an active operating small loan company and not a personal holding company. It is not an "incorporated pocketbook" upon which the personal holding company surtax was intended to fall. This statute when applied to this taxpayer creates through the means of a definition a status contrary to fact, because its effect is to declare that an active operating company is a personal holding company. It constitutes an attempt by legislative fiat to enact into existence a fact which here does not and cannot be made to exist in actuality. The application of this statute to this taxpayer in no measure protects or aids the operation of the Federal income tax. This court has held that a statute creating a status which operates to deny a fair opportunity to rebut it violates the due process clause of the Fifth Amendment.

Moreover, the legislative declaration that this taxpayer, which is in fact an active operating company, shall be a personal holding company for the purpose of imposing tax under the statute here under review, is not a reasonable requisite to prevent tax evasion. In fact, the Congress, subsequently to the enactment of the Personal Holding Company Surtax Statute, concluded that it was not neces-

sary to include small loan companies such as this taxpayer within the statute to prevent tax evasion, and by amendment it expressly removed them from the statute's operation. The determination that the taxpayer is a personal holding company is therefore "unnecessary," "inappropriate," "unreasonably harsh" and "oppressive," when viewed in the light of the expected benefit. In consequence, the guarantee of due process is infringed.

The Personal Holding Company Surtax Statute attempts to enforce compliance with the legislative policy by imposing its tax, which has judicially been declared to be a penalty, not only upon taxpayers evading the income tax or likely to evade such tax, and threatening to defeat the legislative policy, but also upon this taxpayer, which has not evaded taxation and which threatens no harm to the legislative purpose. Congress has recognized the harmless nature of this taxpayer's activity, by expressly removing it from the operation of the statute. It is well established that innocent acts may only be penalized when the prohibition of such acts will aid the legislative purpose. For the reason, therefore, that penalizing the activity of this taxpayer would not promote the legislative objective, the statute would violate the due process clause if it imposed its burden upon this taxpayer.

The question here presented has never before been raised in any other case arising under the Personal Holding Company Surtax Statute, although as stated above the identical issue has been decided favorably by this Court to the contention of this taxpayer in cases arising under other statutes.

The statute should be construed so that it is constitutional. It is clear that if the statute applied to this taxpayer, it would violate the due process clause of the Fifth Amendment. The Personal Holding Company Surtax Statute, therefore, should be construed so as not to apply to the taxpayer, an active operating company.

II.

For the year 1935 the taxpayer filed on Form 1120 a complete sworn and subscribed disclosure of all facts required by Form 1120-H, the personal holding company surtax form, under oath and in due form on or before the due date required by statute for the filing of returns. As soon as the taxpayer learned and realized such a return was deemed insufficient it filed Form 1120-H and marked it "Amended Return." It considered Form 1120-H a supplemental schedule to the return duly filed and only a computing sheet for the additional surtax involved. Therefore, no penalty should be imposed for failure to file a personal holding company surtax return on Form 1120-H for 1935.

WHEREFORE, petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Third Circuit, demanding that Court to certify and send to this Court, for its review and determination on a day certain therein to be named, a full and complete transcript of the record and all proceedings in this case numbered and entitled on its docket "No. 7696 *Girard Investment Company* v. *Commissioner of Internal Revenue,*" and that said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reviewed by this Honorable Court, and that this petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

November 21, 1941

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